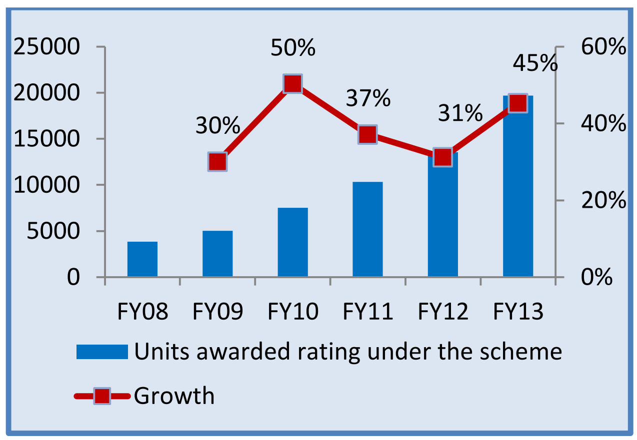
Need of the hour: Micro and Small Enterprises - Enhancing the Penetration of the Rating Scheme

Micro and Small Enterprises (MSEs) are the driving engines for growth of the Indian economy. The sector provides employment opportunities and to the entrepreneurs and workers at relatively lower cost and capital infusion. It also helps in industrialization of the rural and backward areas as also assuring an equitable distribution of income. However, forever challenged by the lack of adequate funds, employable skills and poor technology, MSEs constantly need to be provided with monetary as well as non monetary support. The Performance and Credit Rating (PCR) Scheme has proved to be advantageous to MSEs in terms of easy access to credit, lower interest cost, relaxed collaterals, better acceptance by buyers and vendors, improvement in internal processes of the rated entity based on the feedback provided in the reports, etc. Subsequently, a lot of units are opting for rating under the Scheme and then renewal ratings, even though renewals are not subsidized, unlike the first-time ratings under the NSIC-PCR Scheme. A study by Onicra revealed that approximately 11% of units applied for renewal ratings after being rated under the subsidized scheme due to the perceived benefits. The study also showed that many more units were ready to apply for renewal ratings, once a subsidy is offered on the renewal rating fees.

As per the data available with Onicra, the number of rated entities has increased from 3584 MSEs rated in FY08 to 19676 in FY13 growing at a CAGR of 40%. The increased instance of units being rated is a reflection of the numerous benefits that the units derive under the scheme. The most important benefit is the interest rate reduction that the units get on the facilities availed from the banking and non banking institutions, after the unit is accorded a higher credit rating score by the rating agency.



It was observed in a sample study conducted by Onicra[1] that for the units rated under the PCR Scheme, there could have been a potential interest expense saving of ` 93.1 crore for units rated in FY13 and ` 1500 crore for all the units that have been rated since the inception of the Scheme. The study revealed that Onicra rated entities have benefited by 1.16 percentage points on the interest rate on an average. This translated to an interest rate reduction by 10.7% in FY13 when compared to the interest rates charged in FY12 for the same units. Moreover, the ease of availability of debt finance has prompted the MSE entrepreneurs to increase their own investment in the unit, which is amiable for an employment generative and growth oriented environment in the country.

1: http://www.onicra.com/images/pdf/Publications/Compendium_April2014.pdf

Apart from the MSEs, the maximum benefit has been derived by the banks and the financial institutions (FIs). The banks, especially the public sector banks have been reeling under high Non Performing Assets (NPAs). Lack of robust verification and screening of application, absence of supervision following credit disbursal and shortfalls in the recovery mechanism have led to the deterioration of asset quality of these banks. By providing an unbiased third party opinion on the prospective credit seeker, the reports of the rating agencies under the Scheme, enable the banks and FIs to gauge degree of risk on the exposure and take quick and informed credit decisions. The credit rating score is a measure of credit risk and reflects the varying level of probability of default of a given borrower. The reports prepared under the Scheme strive to reduce the information asymmetry leading to informed decision making and reduced NPAs in one of the highest risk category assets i.e. the MSEs.

In another study conducted by Onicra to study the default rate of MSEs[2] in meeting their financial obligations towards banks and FIs, it was identified that the defaults are lower for the higher rated units. With only a 1.29% default rate among the top three rating categories, the risk of banks is minimized. It helps the banks to maintain lower capital on such units. It may be worthwhile for banks to insist rating under the PCR Scheme, irrespective of the level of exposure. Such an external credit appraisal can be used by the banks in conjunction with their own assessment in order to strengthen their internal credit appraisal system.

Even though the Scheme holds a lot of benefits, it has not been well promoted leading to under-utilization of its full potential. It is high time that the nodal agencies such as the NSIC and the Ministry of MSME enhance the benefit of the Scheme to support its penetration. The Ministry could aid the preferential treatment of units in far flung areas such as Jammu and Kashmir or North Eastern Region to increase their participation in the Scheme. The Scheme can also be further extended to renewal ratings as the perceived benefits are far more than the initial outlay i.e. the subsidy cost to the government. RBI too can extend its hands in promoting the Scheme by asking the banks to make use of the Scheme while appraising credit needs of the MSEs. After all, the growth of MSEs is one of the foundation steps for reviving the economic growth of India.

2: http://www.onicra.com/images/pdf/Publications/Onicra-Default-Study-2013.pdf